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SUBJECT: 2010 INVESTMENT CLIMATE STATEMENT FOR HUNGARY

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¶1. The following is the 2010 Investment Climate Statement for Hungary:

2010 INVESTMENT CLIMATE STATEMENT - HUNGARY

OPENNESS TO FOREIGN INVESTMENT

¶2. Hungary maintains an open economy and attracting foreign investment remains a priority for the Hungarian government. According to the Hungarian Investment and Trade Development Agency (ITDH), "foreign direct investment (FDI) has been crucial in boosting economic performance and remains the driving force behind Hungary's economic success, fueling its strong export growth and significantly increasing productivity." With more than $80 billion in FDI since 1989, Hungary has been a leading destination for FDI in Central and Eastern Europe, although this level is beginning to decline. The global financial crisis hit Hungary in late 2008, and the sharp economic downturn both globally and domestically negatively impacted investment flows into Hungary. Investment from American companies is estimated at more than $9 billion since 1989. There are approximately 2200 companies with partial U.S. ownership, and 128 wholly U.S. owned companies in Hungary.

¶3. Hungary's high-quality infrastructure, its productive and highly skilled labor force, and its central geographic location are often cited as features that make Hungary an attractive destination for investment. Investment promotion agency ITDH views Hungary as a particularly well suited location for research and development centers; manufacturing facilities; and service centers, and believes that considerable opportunities exist in the biotechnology; information and communications technology; software development; renewable energy; automotive; and tourism sectors. ITDH reports that the agency brought in EUR 894 million worth of investments into Hungary in 2009, supporting 27 major investments that created nearly 5,500 jobs.

¶4. Despite Hungary's advantages, some businesses complain that obstacles and disincentives to investment remain, including a lack of transparency and predictability; reports of corruption, particularly in the government procurement sector; and barriers related to excessive red tape. In late 2009, media sources reported several cases in which local and national authorities took decisions that may have unfairly impacted foreign investors. These cases, which are currently being challenged in the courts, include a tender for national radio frequencies and the cancellation of a water services contract in a city in southern Hungary. This led nine Embassies to issue a statement of joint concern over the situation for foreign investors in Hungary (the nine Embassies were Belgium, France, Germany, Japan, Norway, Switzerland, The Netherlands, The United Kingdom and The United States). The November 2009 statement emphasized the need to promote transparency as a competitive advantage for Hungary as it seeks to attract further foreign investment. Officials of the current government as well as representatives of the major opposition party, however, insist that these cases do not reflect a trend and that foreign investors in Hungary are welcome and are treated fairly.

ECONOMIC CRISIS AND RECOVERY

¶5. The global financial crisis hit Hungary with particular severity. Despite declining budget deficits beginning in 2007, concerns about Hungary's macroeconomic vulnerabilities - in particular its high debt-to-GDP ratio and external liability position - caused Hungary to become one of the first emerging markets to suffer from the fallout of the global financial crisis. Investor risk aversion and global deleveraging caused liquidity pressures in Hungary's financial markets and created significant stress in the government securities market. The deleveraging contributed to a significant weakening of the forint, and on October 22, 2008, the Hungarian National Bank increased the policy rate by 300 basis points to fend off a potentially destabilizing swing in the exchange rate.

¶6. In late October 2008, Hungarian authorities requested liquidity support from international organizations, and in early November concluded a USD 25.1 billion assistance package with the IMF, EU, and World Bank to help reduce the government's financing needs and improve long-term fiscal sustainability; maintain adequate capitalization of domestic banks and liquidity in domestic financial markets; and underpin confidence and secure adequate external financing.

¶7. In April 2009, Hungary's new Prime Minister Gordon Bajnai initiated a crisis management program intended to achieve short term crisis management, long term budget equilibrium, sustainable stimulation of growth, and long term restoration of confidence. Unlike most other EU Member States, macroeconomic policy could not be used to support the economy, and fiscal policy had to remain tight to avoid further erosion in investor confidence. Discretionary spending was cut significantly, and the crisis served as a catalyst to implement a number of structural economic reforms.

¶8. The Bajnai government's reform package, designed to help improve fiscal sustainability, included reforms to the pension and social welfare system, as well as changes to the public sector compensation

system. In addition to cuts in discretionary spending, the

government enacted tax reforms aimed at encouraging employment and growth by reducing the tax burden on labor, while remaining revenue neutral by offsetting tax cuts with increases in consumption and wealth-based taxes.

¶9. The government's tight fiscal policies and the gradual improvement in the global economic climate helped bolster market confidence, and the government has been able to return to the market for public sector financing. Significantly, in July 2009 the government successfully concluded a EUR 1 billion Eurobond auction. The narrowing current account deficit has also helped substantially ease government external financing requirements.

¶10. As of January, 2010, Hungary successfully completed four reviews under the IMF Stand-by Arrangement. As a result of the continued improvement in Hungary's external financing conditions, the government declined to draw the amount available to it from the IMF Stand-by Arrangement following the latest review.

¶11. Despite the improving macroeconomic situation, the global economic crisis has had a severe impact on the real economy, as sharply lower demand for Hungarian exports and a steep drop in domestic demand adversely impacted economic growth in Hungary. The unavailability of credit in the months following the onset of the crisis exacerbated the problem, particularly for small and medium sized businesses. A sharp contraction of 6.7 percent is expected for 2009 - more than twice the OECD average. The unemployment rate is expected to peak near 11 percent. As of late 2009, liquidity returned to the banking sector, but loan rates remain down, due to banks' tightening credit conditions and the high costs of forint denominated loans.

FRAMEWORK FOR FOREIGN INVESTMENT

¶12. Since 1989, Hungary has undergone a dramatic transformation from a centrally planned economy to an open, pro-business economy. In 2004 it became a member of the European Union. The Hungarian Constitution guarantees private ownership, right of enterprise, and freedom of competition. The government engages in reasonably transparent regulation. Financial markets are highly developed and smoothly operating, and reflect a level of sophistication indicative of an early reformer in the region.

¶13. The Ministry of Economic Affairs established the Hungarian Investment and Trade Development Agency (ITDH) in 1993, and this agency continues to help companies looking to make major investments in the country. ITDH has set up a "one-stop-shop" service for potential large investors. The government has a National Development Program II (NDPII) for channeling EU development funds and the Smart Hungary investment incentive program, aimed at facilitating investments in key areas for development, especially in less developed regions.

¶14. The reinvigorated Investors' Council continues to operate as a mechanism to maintain Hungary's economic competitiveness and attractiveness to foreign investors. Co-chaired by the Minister of Economy and a leading private sector business executive, it is made up of the largest investors, including foreign investors, economists, NGO's, and business chambers.

¶15. A substantial body of laws protects foreign investment in Hungary, provides national treatment and enables profit repatriation. The most important are the 1988 Law on Business Organizations, as amended in 1997 (no. CXLIV), the 1990 Law on Enterprise, the 1992 law on transforming state companies into economic associations, the 1990 and the 1996 Competition Laws, and the 1995 Privatization Law. Other important laws include the 1991 Law on Bankruptcy, the Law on Securities, and the 1994 Law establishing the Commodity Exchange. Legislation is uniform for all investors regardless of their origin. Institutions and procedures are in place to ensure compliance with legislation and competition rules. The applicability of these laws extends without differentiation to domestic and foreign investors.

¶16. The most notable legislation protecting both foreign and domestic investors is the Foreign Investment Act of 1988. It grants full protection to the investments and businesses of non-Hungarian resident investors and guarantees that investors will be treated in the same manner as national investors. The Act also contains a repatriation guarantee under which foreign investors are free to remit profits and investment capital to their home country in the event of partial or complete termination of their enterprise.

¶17. Commercial law in Hungary is well developed; however, most analysts see both a need to continue to revise the corporate legal code and to improve the judicial and administrative capacity for enforcing it. There continue to be complaints from foreign investors about the slow pace of the judicial system, and the need for timelier judicial due process.

¶18. Up to 100 percent foreign ownership is permitted with the exception of designated "strategic" holdings in some defense-related industries. Foreigners investing in financial institutions and insurance companies must officially notify the government but do not need advance authorization. Foreign financial institutions may operate branches and conduct cross-border financial services in Hungary, in keeping with OECD commitments. Currently, foreign firms control two-thirds of manufacturing, 90 percent of

telecommunications, and 60 percent of the energy sector. The private sector currently produces about 80 percent of Hungary's output.

¶19. The Hungarian State Holding Company (MNV) became the legal successor to the Hungarian Privatization and State Holding Company (APV) in 2008, and is responsible for managing and privatizing state-owned properties. With most state-owned companies now privatized, however, the pace of privatizations has slowed considerably in recent years.

¶20. Ownership in Hungary is considerably more concentrated than in the U.S. It is common for one or two stockholders to have a controlling stake in even large corporations. Crossholdings are common and the independence of directors sometimes difficult to establish.

¶21. Land-Ownership Restrictions: Under the Investment Act, a company incorporated in Hungary may only acquire real estate "required for its economic activities," but this has been broadly

interpreted and has not prevented foreign entrepreneurs from engaging in property development. The 1994 Land Law restricts the purchase of land by foreigners to 6,000 square meters, but allows for leases of up to 300 hectares for a maximum of 10 years. Only private Hungarian citizens and EU citizens resident in Hungary and engaged in agricultural activity can purchase farmland, while others may lease it. Restrictions on foreigners buying land will remain in force for seven years following EU membership and it is possible they could be extended for an additional three years.

CONVERSION AND TRANSFER POLICIES

¶22. The Hungarian forint (HUF) has been convertible for essentially all business transactions since January 1, 1996. As a legal obligation of its EU membership, Hungary must eventually adopt the Euro. Hungary complies with IMF Article VIII and all OECD convertibility requirements. Act XCIII of 2001 on Foreign Exchange Liberalization lifted all remaining foreign exchange restrictions and allowed free movement of capital in line with EU regulations. Foreign currencies are freely available in all banks and exchange booths. In 2001, Hungary adopted an exchange rate intervention band of +/-15 percent around a benchmark rate against the Euro. In order to allow the Hungarian National Bank (MNB) to exclusively focus on its inflation target of 3 percent, in February 2008 the MNB adopted a free-floating exchange rate regime. Since that date market forces determine the HUF exchange rate to the Euro and other currencies.

¶23. Although the current government notes that adoption of the Euro remains a priority, a specific target date for entry has not been set. Recent reforms are helping to strengthen Hungary's fiscal sustainability and will bring Hungary closer to meeting the conditions required for entry into the Exchange Rate Mechanism II (ERM II), one of the "Maastricht Criteria" required for Euro adoption. With national elections in April 2010, the timing of Hungary's entry into the Eurozone will largely depend on the economic policies and priorities of the next government. All major political parties have expressed support for Hungary's adoption of the Euro.

¶24. Short-term portfolio transactions, hedging, short and long-term credit transactions, financial securities, assignments and acknowledgment of debt may be carried out without any limitation or declaration. While the Forint remains the legal tender in Hungary, parties may settle financial obligations in a foreign currency.

¶25. Hungarian legislation allows for profit repatriation and re-investment. The timeframe for remittances are in line with the financial sector's normal timeframes (generally less than 30 days), depending on the destination of the transfer and if corresponding banks are easily found. There is no limitation on the inflow or outflow of funds for remittances of profits, debt service, capital, capital gains, returns on intellectual property, or imported inputs.

EXPROPRIATION AND COMPENSATION

¶26. A 1990 Constitutional amendment provides protection against expropriation, nationalization, and any arbitrary action by the government except in cases of acute national concern. In such cases, immediate and full compensation is to be provided to the owner. There are no known cases where the Hungarian government has discriminated against U.S. investments, companies, or representatives in expropriation.

DISPUTE SETTLEMENT

¶27. Hungary has an independent judiciary and well-developed system of commercial law. The legal process, however, can be quite lengthy. Hungary modernized its court system as of January 1, 2003. A new level has been added to the previous three-level court system, which consisted of Local Courts, Courts of Appeal, and the Supreme Court. In order to decrease the workload of each court and, as a consequence, reduce the time of the appeal process, the Parliament established five regional courts called the High Court of Justice. EU membership empowers private parties to appeal violations of EU rights or regulations directly to EU bodies, providing another means of redress in potential disputes. Investment disputes are infrequent and do not reflect a pattern in Hungary. Mediation is spreading, but is not yet a widely used means to settle disputes.

¶28. Contracts can include sole arbitration by a foreign court.

Contractual rights have to be met and failure to do so can be challenged in court. Proceedings and rulings can belengthy and the legal system is slow and overburdened. Courts and the prosecution are independent and there is no evidence of influence by the government.

¶29. The Act on Bankruptcy Procedures, Liquidation Procedures and Final Settlement, as amended in 1993, covers all commercial entities except banks (which have their own regulatory statutes), trusts, and state-owned enterprises. Bankruptcy proceedings can be initiated only by the debtor provided he/she has not sought bankruptcy protection within the previous three years. Within 90 days of seeking bankruptcy protection, the debtor must call a settlement conference to which all creditors are invited. Majority consent of the creditors present is required for all settlement plans. If agreement is not reached, the court can order liquidation. The Bankruptcy Act establishes the following priorities of claims to be paid: 1) liquidation costs; 2) secured debts; 3) claims of individuals; 4) social security and tax obligations; 5) all other debts. Creditors may request the court to appoint a trustee to perform an independent financial examination. The trustee has the right to challenge, based on conflict of interest, any contract concluded within 12 months preceding the bankruptcy.

¶30. Hungary has accepted binding international arbitration in cases where the resolution of disputes between foreign investors and the state is unsuccessful. There are domestic arbitration bodies within the Hungarian Chamber of Commerce, the Ministry of Labor, and local municipal governments. Hungary is a member of the International Center for the Settlement of Investment Disputes (ICSID). Hungary is also a signatory to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. In the last few years mediation has become a tool of increasing importance for dispute settlement to avoid lengthy court procedures.

PERFORMANCE REQUIREMENTS/INCENTIVES

¶31. Performance requirement/incentives are available to all enterprises registered in Hungary, regardless of the nationality of owners or location of incorporation, and applied on a systematic basis. To comply with European Union rules, the government of

Hungary no longer grants tax holidays based on investment volume.
¶32. Eligibility for incentives is regulated by GOH Decree 163/2001, as amended by 241/2002, in accordance with EU regulations. Incentives can be received by tendering procedures for: (1) research and development, employment, training; (2) economic sectors; or (3) regions. The government defines an intensity indicator for incentives, which is the maximum value of the totl of various incentives in proportion to the present value of the investment. This can be higher for less developed areas or for small and medium sized enterprises (SMEs).
¶33. Hungary has a well developed incentive system for investors, the cornerstone of which is a special incentive package for investments over a certain value (typically over EUR 10 million). The incentives are focused on investors establishing manufacturing facilities, logistics facilities, regional service centers, R&D facilities, bioenergy facilities, or tourist facilities. Incentive packages may consist of cash subsidies, development tax allowances, training subsidies, and job creation subsidies. The incentive system is compliant with EU regulations on competition and state aid and is administered by the Hungarian Investment and Trade Development Agency and managed by the Ministry of Development and Economy.
¶34. Parliament enacted a new National Development Plan for 2007-2013. In the Framework of the New Hungary Development Plan (NHDP), Hungary will receive around 7,000 billion HUF (22.4 billion Euros) from the EU. This will be complemented by the national public contribution amounting to 15 percent of the total available funding. The Hungarian government will add to this amount around 1,000 billion HUF. Projects using EU structural and cohesion funds will be subject to a series of requirements, including a portion of own-source financing. As these programs become implemented, the inflow of EU funds will create numerous opportunities for investment. In an attempt to ease the effects of the global financial crisis, the GOH initiated an economic stimulus package worth 1,400 billion HUF for businesses, including SMEs that have been particularly affected by the unavailability of credit. In the current climate, loans have been hard to obtain even for SMEs with good credit histories, and expiring loans have been hard to renew. The package includes a HUF 377 billion liquidity package (micro loans, SME loans, Hungarian Development Bank loans), a credit guarantee of HUF 76 billion, as well as interest and venture capital subsidies from the New Hungary Development Program and the New Hungary Rural Development Program. The division of EU Resources for the Sectoral Operative programs is as follows (2007-2013): [see emailed chart]
¶35. Performance requirements, such as job creation or investment minimums, can be imposed as a condition for establishing, maintaining, or expanding an investment. There is no requirement that investors purchase from local sources, however the EU Rule of Origin applies. The government imposes "offset" requirements for defense sector investments over one billion forint. Investors are

not required to disclose proprietary information to the government as part of the regulatory process. There are no restrictions on participation in government financed or subsidized research and development programs.
Visa, residence, and work permit requirements are a lengthy and tedious hurdle but do not inhibit foreign investors' mobility. Employment of foreign nationals must meet Hungarian Labor Code requirements.
¶36. There have been no complaints against Hungary related to any failure to fulfill any trade related investment measures (TRIMS) treaty obligation.

RIGHT TO PRIVATE OWNERSHIP AND ESTABLISHMENT

¶37. The Hungarian constitution guarantees the right to private ownership. Foreign and domestic private entities may establish and own business enterprises and engage in all forms of remunerative activity, except those prohibited by law. Hungarian law guarantees the right of establishment of private entities, as well as the right to acquire and dispose of interests in business enterprises. Many foreign companies operate through representative offices.
¶38. The Foreign Investment Act of 1988 grants full protection to the investments and businesses of non-Hungarian resident investors. The Act guarantees that investors will be treated in the same manner as national investors, and contains a repatriation guarantee under which foreign investors are free to remit profits and investment capital to their home country in the event of partial or complete termination of their enterprise.
¶39. The registration of business associations is compulsory in Hungary. All firms registered in Hungary are under the Court of Registration's legal authority. The Court maintains a fully computerized registry, provides public access to company information, and is developing an electronic filing system. The Court also enforces compliance with the Company Act, enacted in June 1998, which compels registry courts to process applications to register limited liability and joint-enterprise companies within 30 days (60 days for unincorporated business entities). If the court fails to act in the period, the new company is automatically registered. The act eliminated separate registrations at the tax and social security authorities. The minimum capital required for a limited-liability company is HUF 3 million and for a joint stock company it is HUF 20 million. As of July 1, 2008, businesses may be established in one hour's time electronically or by a simplified registration procedure. GOH announced the intention to decrease administrative burdens by 25 percent by 2012.

PROTECTION OF PROPERTY RIGHTS

¶40. Secured interests in property (mortgages), both movable and real, are recognized and enforced but there is no title insurance in Hungary.
¶41. Intellectual Property Rights: On January 1, 2003, Hungary acceded to the European Patent Convention and has accordingly amended the Hungarian Patent Act. It is a party to the WTO Trade Related Aspects of Intellectual Property Rights (TRIPS) agreement and most other major international IPR agreements, including the most recent World Intellectual Property Organization (WIPO) copyright Treaty and the WIPO Performance and Phonograms Treaty. It is also a party to the EU Information Society Directive, and implemented the EU Enforcement Directive in 2005.
¶42. The United States and Hungary signed a Comprehensive Bilateral Intellectual Property Rights (IPR) Agreement in 1993 that addresses

copyright, trademarks and patent protection. A subsequent industrial property and copyright law entered into force on July 1, 1994, that significantly strengthened the domestic patent system. A new Copyright Law passed in June 1999 made necessary technical changes required by the WTO TRIPS Agreement.

¶43. The 1993 IPR agreement recognizes an exclusive right to authorize the public communication of works, including the performance, projection, exhibition, broadcast, transmission, retransmission or display of these works. It also requires that protected rights be freely and separately exploitable and transferable (contract rights), and recognizes an exclusive right to authorize the first public distribution, including import, for protected works.

¶44. Patent protection in Hungary covers the use, sale, offering for sale, and import of a patented product or products made using a patented process. The definition of infringement has been extended to include "supplying the means." A person who sells or offers to sell the means of producing a patented product is liable if that person is proven to have known that the means could be used for infringement. An example is the sale of decoder boxes that would allow the user to pirate a cable signal.

¶45. Under the revised Patent Act, effective January 1, 1996, an invention may be patented if it is novel and has industrial application. The patent application process takes from six months to one year, and patents are issued for a period of twenty years from the filing date. Foreigners applying for a Hungarian patent whose permanent residence is not in the European Economic Area (EEA) must be represented by an authorized Hungarian patent agent. Hungarian patent law conforms to the guidelines of the European Patent

Convention, to which Hungary is a signatory.

¶46. Trademarks may be granted for any product-distinguishing sign capable of being graphically represented. They are issued for ten years and are renewable. The Hungarian Patent Office has competency over patent revocation and trademark invalidity proceedings, while all disputes related to the infringement of IPR fall under the jurisdiction of the courts.

¶47. In May 2004 the United States Trade Representative (USTR) announced that Hungary was placed upon the Special 301 Watch list of countries owing to weak enforcement and inadequately protected confidential pharmaceutical test data. The government of Hungary has taken some positive steps towards more complete implementation of its international obligations by putting into effect a ministerial decree to provide data exclusivity protection for pharmaceutical products authorized in the EU or Hungary after April 11, 2001.

¶48. In January 2008, the GOH established a National Board Against Counterfeiting and Piracy (HENT), led by a government commissioner, the Hungarian Patent Office (HPO), and the Ministry of Justice (MOJ), with participation from law enforcement and other government agencies, various business chambers, industry associations, and NGOs. The Board established a strategy until the end of 2010, which was approved by the government in October 2008. Since its creation, the HENT has undertaken a number of positive measures to increase training of judicial and law enforcement officials, improve coordination between rights-holders and law enforcement officials, and increase public awareness of the importance of intellectual property rights protection. One area of ongoing concern, however, is that judges do not tend to impose deterrent-level sentences for civil and criminal IP infringement, although this is slowly changing.

TRANSPARENCY OF THE REGULATORY SYSTEM

¶49. The regulatory process in Hungary is relatively open and transparent. Tax, labor, environment, health and safety laws are consistent with EU regulations. Laws before Parliament can be found on the Parliament website. Legislation, once passed, is published in a legal gazette and available online. The government often invites interested parties to comment on draft legislation but does not always incorporate that input into final documents. Foreign investors would like to see more consultations between government and stakeholders in drawing up regulations. Some regulatory functions are delegated to professional associations, such as medical and legal associations. In addition, several permanent advisory committees may review draft laws and rules. However, in most cases the government has complete discretion over who sits on these boards, over whether or not the boards see draft decrees before they are promulgated and whether or not to accept the boards' input in making final regulations. The bureaucratic procedures can be very lengthy.

¶50. There are some exceptional types of regulations where consultation with the public is required, including environmental and land use regulations. The Environmental Act (LIII/1995) and the Regional Development and Country Planning Act (XXI/1996) require the government to solicit input from affected parties. Open-ended public hearings are uncommon, and the courts generally cannot review administrative decisions. Some ministries are beginning to put draft rules and laws on the Internet and to invite comments, but this practice is not yet widespread.

¶51. A revised Public Procurement law came into force on May 1,
¶2004. The current Hungarian government extended the law to investments financed by the Hungarian Development Bank and increased the number of open tenders. Companies operating in subsidies or price-regulated sectors may suffer due to insufficient transparency and responsiveness in the setting of prices or subsidies. In response to continued international criticism regarding Hungary's procurement laws and practices, a bill to modify existing public procurement legislation and make it more transparent was passed by Parliament in 2008. Parties requesting bids will be required to post information on their websites about the project and results of the public procurement process. Additionally, bids will need to indicate all subcontractors that will be used and how they will participate in the project. The new law also simplifies the current process by reducing the amount of paperwork for bidders.

¶52. According to Transparency International's National Integrity Study, systemic corruption adds as much as 20-25 percent to the costs of government procurement. A Freedom House study estimates that only 10 percent of government procurements are transparent. Government procurement reform is a major topic of discussion among foreign chambers of commerce and business groups that have provided

input and suggestions to the GOH for inclusion into draft legislation. The Accounting Law of 2000 and subsequent modifications were designed to bring Hungarian financial reporting standards and practices in line with the International Accounting Standards and the EU Fourth and Seventh Directives. Under the latest modification, effective January 1, 2005, listed companies under the scope of Decree 1606/2002 of the EC are obliged to prepare consolidated financial statements in accordance with international

financial standards, except for companies which are subsidiaries of a parent company already preparing a consolidated annual report.

¶53. In December 2009, Parliament passed new measures designed to reduce the possibility of corruption in public procurements by granting protection to whistleblowers, establishing a Public Procurement and Public Interest Protection Office, and supporting the use of "Integrity Pacts" in public procurements. Although a positive step, these new provisions have not yet entered into force in Hungary.

EFFICIENT CAPITAL MARKETS AND PORTFOLIO INVESTMENT

¶54. Prior to the global financial crisis, capital adequacy was not an issue in Hungary as funds were readily available for businesses due in large part to a large foreign presence and significant competition in the banking sector. Currently, however, banks are increasing their capital adequacy ratios to well above the required 8 percent, and are reducing loan-to-debt ratios as well. Lack of confidence in financial markets affected Hungarian banks, many of which are now limiting foreign currency denominated lending, and previously popular Swiss franc and Japanese yen loans have largely disappeared. There are reports that forint loans to businesses are hard to obtain as well, as banks increase their debt-to-loan ratios, forcing them to promote deposits aggressively and limit lending to the less risky consumer loan sector. On the whole, foreign investors continue to have equal access to credit on the local market, with the exception of special governmental credit concessions such as small busness loans. Markets for direct finance are thin. Volumes on the stock exchange declined and the BUX plummeted to just above 12 thousand, about 50 percent of the previous average index, but have since rebounded to near pre-crisis levels.

¶55. Hungary has an impressively modern financial sector. In April 2000, the responsibilities of the Bank Supervisory Board were merged with the state insurance and pension supervisory agencies to form the Hungarian Financial Supervisory Authority (PSZAF). This body is a consolidated financial supervisor regulating all financial and securities markets. The PSZAF is independent, self-financing and well staffed, but lacks the ability to issue new regulations that carry legal force. In order to increase its ability to better foresee possible problems in the financial sector, PSZAF's authority was increased through a package of modifications to existing financial laws passed by Parliament in late 2009. These include stricter regulations on loans for private individuals, better information about exact loan conditions and costs, and a code of ethics for banks. These changes are designed to prevent individuals from taking on loans they are unlikely to be able to repay and provide better protection for those who cannot meet current installments and wish to change their loan conditions or opt for early repayment. Most of the new legislation entered into force on January 1, 2010. Additional draft legislation includes regulations empowering PSZAF to draft and submit legislation to Parliament. If passed, it would create a strong two-pillar system of control by the Central Bank and the PSZAF over the financial sector, and provide new tools to allow them to address systemic and other risks.

COMPETITION FROM STATE-OWNED ENTERPRISES (SOES)

¶56. Beginning in the 1990s, there has been considerable privatization of former state-owned enterprises. Today, few SOEs remain, and primarily operate in strategic sectors, for example in the areas of national security and transportation. We are aware of few complaints from private companies regarding competition from SOEs. In October 2009, however, newspapers reported that a private company was denied a license to provide express bus service between Budapest and five major Hungarian cities. The company would have competed directly with the state-invested Voln companies.

CORPORATE SOCIAL RESPONSIBILITY (CSR)

¶57. Since the mid-1990s, corporations began to pay more attention to social responsibility. Foreign long-term investors have "imported" their CSR mechanisms, policies and models, which local Hungarian corporations have begun to adopt. According to a survey conducted by CSR Hungary, 55 percent of businesses have a CSR policy and 44 percent of businesses think that CSR increased their competitiveness. The Hungarian Business Leaders Forum (HBLF), a non-profit representative body of local and international business leaders in Hungary, considers CSR as part of its mission. In 2006 GOH signed a strategic resolution (No. 1025) for the reinforcement of social responsibility of employers. Since 2006 CSR Hungary has held an annual conference - the country's largest CSR forum - where company and communication managers, researchers and university students exchange information and experiences, and where an annual CSR award is presented.

PRICE REGULATION AND LIBERALIZATION

¶58. The Price Act of 1990 authorizes the government to determine compulsory prices when the Competition Act fails to protect interests of consumers. This sets the upper or lower price limit for certain goods and services to be established by a relevant government authority.

Foreign companies operating in price-regulated sectors, such as energy and pharmaceuticals, have suffered decreased margins due to

government delays in adjusting prices upward and extending subsidies to new drugs. Multinational pharmaceutical firms believe they have spent considerable time negotiating with the Ministry of Health with little effect on the price and reimbursement policies of the national health system. Many pharmaceutical companies see the current government plan for pharmaceutical subsidies as impractical.

¶59. Substantial market deregulation has occurred over the past few years. The electrical market is being unbundled and largely

privatized. In June 2003, the Hungarian government passed the Gas Act, which provided the framework for gradual liberalization of the natural gas market from January 2004. On the other hand, that same Act has arguably reduced the political autonomy of the Hungarian energy regulatory office. In 2007 the GOH initiated electricity and natural gas market liberalizations, both of which are slated for completion in 2009, although the Hungarian Energy Office will continue to regulate gas prices.
PORTFOLIO INVESTMENT
¶60. The 1996 Offering of Securities, Investment Services and Securities Exchange Act, and the 1990 Securities and Stock Exchange Act govern the public issuance and trading of bonds, shares and other securities. The Budapest Stock Exchange (BSE) has 35 members, which are licensed-broker or broker-dealer companies, including several U.S.-based firms. It is a full member of the Federation of International Stock Exchanges and an associate member of the International Securities Market Association. The total market capitalization in 2009 amounted to EUR 62.8 billion, of which shares amount to EUR 20.5 billion, government bonds and treasury bills amount to EUR 36.5 billion. Average daily turnover was EUR 78 billion, which is 9.6 percent lower than in 2008. In November 2005, the BSE integrated the Commodity Exchange, creating a commodities section. In December 2009 the BSE listed a total of 69 issuers. These include 46 equity, 5 bond, 3 mortgage, 15 investment funds, and one government bond and T-bill issuer. Sixty-six percent of capitalization is concentrated in four companies (MOL, OTP, Magyar Telecom and Richter).
POLITICAL VIOLENCE
¶61. Despite frequent protests since 2006, political violence has not been a characteristic of the political landscape in Hungary. The transition from communism to democracy was negotiated and peaceful, and four peaceful changes of government via the ballot box have followed. There is little cause to expect insurrections, political terrorism, or interstate war. There has been no violence directed against foreign-owned companies, although Hungary's economic troubles have contributed to an increase in political extremism.
CORRUPTION
¶62. The Hungarian Ministry of Justice is responsible for combating corruption. There is a growing legal framework in place to support its efforts. Hungary is a party to the OECD Anti-Bribery Convention and has incorporated its provisions into the penal code, as well as subsequent OECD and EU requirements on the prevention of bribery. Hungary adopted a national strategy on combating corruption and passed two modifications of the Criminal Code in 2001 (Act CXXI and CIV). Parliament also passed the Strasbourg Criminal Law Convention on Corruption (Law XLIX of 2002) and the Strasbourg Civil Code Convention on Corruption (Law L of 2004). Hungary is a member of GRECO (Group of States against Corruption), an organization established by members of the Council of Europe to monitor the observance of their standards for fighting corruption. Transparency International (TI) is active in Hungary and its 2009 Corruption Perceptions Index rates Hungary 46th out of 102 countries (1st being best), more favorably than most other countries in the region, but worse than Hungary's 2004 ranking of 34th.
¶63. Giving or accepting a bribe is a criminal offense, as is an official's failure to report a bribery incident. Penalties can include confiscation of assets, imprisonment, or both. Since EU membership, legal entities can also be prosecuted. An extensive list of public officials and many of their family members are required to make annual declarations of assets, but there is no specified penalty for making an incomplete or inaccurate declaration. The 2003 "glass pocket law" extended the State Audit Office right to review businesses' government contracts to public-private transactions that were previously considered "business-confidential". Conflict of interest legislation prohibits members of parliament from serving as executives of state-owned companies.
¶64. While legislation is in place, persistent suspicion of corruption in some government procurement actions has arisen, due to a lack of transparency and an uneven implementation of the laws to prevent corruption. Non-governmental organizations, the business community, and foreign governments share many of these concerns, and maintain an ongoing dialogue with the government to identify strategies to improve conditions. The GOH has also set up an Anti-Corruption Coordination Board, led by the Ministry of Justice, with participation from other government ministries, chambers and NGOs, which submitted a strategy and action plan to Parliament in
¶2008. Another issue TI actively supports is a transparent party

financing system, especially important before elections in April
¶2010.
¶65. Hungarian legislation on combating money laundering is in line with international obligations. Act LXXXIII of 2001 on Combating Terrorism, on Tightening Provisions on Impeding Money Laundering widened the scope of the 1994 anti-money laundering legislation. Act XV of 2003 on Preventing Money Laundering increased the scope of business under the anti-money laundering legislation. It now includes financial and supplementary financial service providers, investment service providers, Stock Exchange-related activities, money transfers via postal service, real estate agents, auditors, tax advisors, casinos, retailers of precious metals, gems, antiquities, insurance companies, and lawyers.
BILATERAL INVESTMENT AGREEMENTS
¶66. Hungary and the United States do not have a bilateral investment treaty (BIT), nor is one currently under negotiation.
¶67. Hungary has bilateral investment treaties with the following countries: Argentina, Australia, Austria, Belgium, Bulgaria, Canada, China, Cyprus, Czech Republic, Denmark, Egypt, Finland, the Federal Republic of Yugoslavia, France, Germany, Great Britain, Greece, Indonesia, Israel, Italy, Kazakhstan, Kuwait, Luxembourg, Malaysia, Moldova, The Netherlands, Norway, Paraguay, Poland, Romania, Slovakia, South Korea, Spain, Sweden, Switzerland, Thailand, Turkey, Ukraine, Uruguay and Vietnam.
¶68. Hungary has tax treaties which eliminate many aspects of double taxation with the following countries: Albania, Australia, Austria, Belgium, Brazil, Bulgaria, Canada, China, Croatia, Cyprus, Czech Republic, Denmark, Egypt, Finland, the Federal Republic of Yugoslavia, France, Germany, Great Britain, Greece, India, Indonesia, Ireland, Israel, Italy, Japan, Kazakhstan, Kuwait,

Luxembourg, Malaysia, Malta, Moldova, Mongolia, The Netherlands, Norway, Pakistan, Philippines, Poland, Portugal, Romania, Russia, Singapore, Slovakia, South Korea, South Africa, Spain, Sweden, Switzerland, Thailand, Turkey, Tunisia, Ukraine, the United States, Uruguay and Vietnam. Negotiations were recently concluded to revise Hungary's current tax treaty with the United States.

TAXATION

¶69. In 2009, the Bajnai government enacted tax reforms aimed at encouraging employment and growth by reducing the tax burden on labor, while remaining revenue neutral by offsetting tax cuts with increases in consumption and wealth-based taxes. The tax changes eliminated the 4 percent so-called "solidarity tax," but the corporate tax was increased from 16 to 18 percent. Employer welfare contributions were lowered, the brackets for the two tax rates broadened, and tax rates lowered, creating a flatter system. Currently there is a tax rate of 17 percent for annual income below HUF 5 million and 32 percent for incomes exceeding this amount. Despite the tax cuts, Hungary still maintains a relatively high tax wedge.

¶70. As several newly acceded EU members decreased both their corporate and personal income tax rates and/or switched to a one-tier tax system, Hungary faces strict competition in the region. Additionally, businesses sometimes complain that they are targeted for lengthy audits and competition investigations. Tax changes in the government reform program had the effect of abrogating certain preferential tax agreements for foreign investors.

OPIC AND OTHER INVESTMENT INSURANCE PROGRAMS

¶71. The U.S. Overseas Private Investment Corporation (OPIC) has operated in Hungary since October 1989, offering U.S. investors financing through direct loans or guarantees, political risk insurance, and capital for private equity funds. OPIC helps U.S. companies compete in new markets and developing countries when traditional lenders or financing is not available. OPIC's financial support ranges from small micro financings to large infrastructure project loans.

LABOR

¶72. Hungary's civilian labor force of 3.9 million persons is highly skilled. Literacy exceeds 98 percent and about two-thirds of the work force has completed secondary, technical or vocational education. Hungary is particularly strong in engineering, medicine, economics, and science training. An increasing number of young people are attending U.S. and European-affiliated business schools in Hungary. Foreign language skills, especially in English and German, are becoming more widespread.

¶73. Hungary's unemployment increased from 7.9 percent in 2008 to 10.4 in 2009, and is currently exceeding the EU-27 rate of 9.3 percent and that in all of the neighboring countries. The labor participation rate is still low by European standards at 55.6 percent, which is 1.6 percent lower than in 2008. Despite increasing rates of unemployment, in certain sectors there still is a shortage of skilled and well educated employees. Regional differences in employment opportunities still prevail. The northwest region of the country sometimes sees shortages of skilled workers, particularly in the financial and marketing sectors, but east of the Danube unemployment levels are above average, though the labor force is cheaper and comparably skilled. The government is now turning its focus to help education adapt better to labor market requirements

and is encouraging cooperation between higher education institutions and the business arena. Wages in Hungary are significantly lower than those of Western Europe. Average Hungarian labor productivity is lower than the EU average, but greater than that of other Central and Eastern European economies.

¶74. Hungary's labor law, in force from July 1, 2003, made several important changes to labor market regulation. The law applies stricter guidelines regarding which personnel may be employed asindependent contractors and which must be considered employees (using a "service" agreement versus an "employment agreement"). Companies with an EU-wide presence must institute European works councils, which act as a mechanism for sharing information between labor and management.

ROLES OF GOVERNMENT AND TRADE UNIONS

¶75. A tripartite National Council for Interest Reconciliation is legally recognized by the Hungarian Labor Law (Labor Code XXII/1992). Members of the Council are representatives of employers, employees, and the government. In practice, the Council has six trade union representatives and nine employer representatives. The Hungarian minimum wage is set by agreement of all three parties. The law also requires the government to consult with the Council on issues affecting labor, such as health and safety. The Council is the only group that must legally be consulted on many labor issues, even though only about 25 percent of the workforce is unionized.

¶76. The Hungarian labor code guarantees the right to join trade unions and gives unions the right to operate inside a company. Unions are entitled to negotiate collective bargaining agreements. The labor code limits the length of the workday plus overtime to 12 hours; guarantees maternity leave; provides for at least 20 days of annual leave; mandates at least 30 days notice prior to severance and requires severance pay for those employed at least three years. The law forbids discrimination based on gender, age or nationality. The minimum employment age is 16 years, though apprenticeships may begin at age 15. Hungary adheres to ILO conventions protecting worker rights. Labor/management relations are better than in much of Europe. As a result of the current economic situation, labor-related strikes are occurring with increasing frequency.

FOREIGN TRADE ZONES/FREE PORTS

¶77. The 1988 Law on Foreign Investment, the 1995 Law on Customs, Customs Procedures, and the 1995 Law on Foreign Currency permitted and regulated the operation of foreign trade zones. Prior to Hungary becoming a full member of the EU, 143 companies operated in about 130 customs free zones, producing about half of total Hungarian exports.

¶78. According to Law CXXVI of 2003, permits for operating in customs free zones expired. Currently no company operates in customs free zones and all of them transferred their assets and continued operation following customs handling of their assets. The Finance Ministry plans to nominate customs free zones, but currently there seems to be little demand for this service. Possible sites could include Szekesfehervar, Gyor, Kecskemet, Miskolc, Zahony or Szombathely.

FOREIGN DIRECT INVESTMENT (FDI) STATISTICS
¶79. According to the National Bank of Hungary, foreign direct investment between 1995 and the third quarter of 2008 amounted to EUR 60.4 billion (which includes shares, other participation, and reinvested incomes). Since a record high of EUR 6.2 billion in 2005, FDI has been declining. (EUR 5.7 billion in 2006, EUR 4.2 billion in 2007, and EUR 3.0 billion in 2008). In 2009 and 2010, as a result of the global economic crisis, FDI inflow is expected to fall to EUR 1.5-3 billion, before recovering somewhat in 2011. Leading foreign investors include Germany, Austria, the Netherlands, and the United States. Seventy-seven percent of total FDI is from the EU. 36.5 percent of cumulative FDI in Hungary is in manufacturing, 14.8 percent in trade and retail, 12 percent in services, and 12 percent in financial activity. Hungary has a reasonably significant level of foreign investment abroad, primarily through acquisitions in other Central and Eastern European countries. By the third quarter of 2009, total Hungarian investment abroad amounted to 11.1 billion Euros. The majority of this is directed to services and crude oil processing.
¶80. Of the U.S.'s 50 largest multinationals, 40 are present in Hungary. The following U.S.-based companies have made major direct investments here: GE, Alcoa, AES, Coca-Cola, O-l (Owens Illinois), General Motors, Guardian Industries, IBM, Lear Corporation, Pepsi Co, Sara Lee, Procter & Gamble, Visteon, Ford, Citibank, Emmis International, Emerson, Zoltek, PACCAR, Celanese, Exxon Mobil, EDS, Sykes, Jabil Circuit, McDonald's, Burger King, National Instruments, AIG/Lincoln, HP, Cisco, Microsoft, Oracle, Johnson and Johnson, Pfizer, Lilly, Monsanto, Dow Chemical, to name a few.
¶81. Among the largest non-U.S. foreign investors in Hungary are: Deutsche Telekom, Audi, Nokia, Telenor, Vodafone, E.ON, Sanofi-Aventis, Electrolux, RWE, Tesco Global, Suzuki Motor, Auchan, Hankook, Mercedes Benz, SAP, ABB, Philips, CP Holdings and Robert Bosch.

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